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ABSTRACT

Somerville Charter School was among 24 Massachusetts charter schools included in a study undertaken by the Office of the Inspector General in March 1998. The office identified weaknesses in the contracting practices, procurement procedures, and financial management of some schools, including Somerville. These weaknesses could undermine the schools' ability to achieve their educational objectives and jeopardize the interests of state taxpayers whose dollars fund charter schools. The study was followed by an audit review in November 1999, which generated this report. The Inspector General recommends that the Board of Trustees should hire its own staff to oversee the school's business operations; should consider managing the school's business operations with its own staff when the school's contract with its service company, SABIS, Inc., expires in 2001; should oversee the preparation and execution of the school's annual budget; should select, contract with, and oversee the school's independent auditor; and should seek guidance regarding its fiduciary duty and establish procedures to comply with the requirements of the open meeting law. Three tables illustrate school financial activities. Appendix A is the response of the Somerville Charter School Board of Trustees to the report of the Office of the Inspector General. (RT)

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Office of the Inspector General

Commonwealth of Massachusetts

ED 456 527

Somerville Charter School: Management Issues and Recommendations

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Inspector General

January 2001

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January 2001

His Excellency the Governor

The Honorable President of the Senate

The Honorable Speaker of the House of Representatives

The Honorable Chairman of the Senate Ways and Means Committee

The Honorable Chairman of the House Ways and Means Committee

The Honorable Chairman of the Senate Post Audit and Oversight Committee

The Honorable Chairman of the House Post Audit and Oversight Committee

The Directors of the Legislative Post Audit and Oversight Bureaus

The Secretary of Administration and Finance

Members of the General Court

Omnibus ad quos praesentes literae pervenerint, salutem.

I am today releasing a report concerning the business operations of the Somerville Charter School. Under the charter school law, charter schools are public schools governed by volunteer boards of trustees. Since 1996, the Somerville Charter School has contracted with a private company to provide comprehensive school management services.

The Board of Trustees of the Somerville Charter School has devoted substantial time and effort in service to the School. Nevertheless, the findings presented in this report illustrate some of the risks of allowing a private contractor to control a public organization's finances and business operations. Any organization that contracts out major, mission-critical functions is responsible and accountable for effective contract oversight. Charter schools, which are not subject to the municipal procurement and municipal finance laws that apply to other public schools in Massachusetts, must ensure

that their contracting arrangements with private school management companies protect the financial interests of the School while providing the necessary transparency and accountability.

I am pleased the Somerville Charter School Board of Trustees plans to make constructive use of my Office's work in order to improve the management and financial structure of the School. The recommendations provided in this report are intended to strengthen the School's long-term capacity to serve its students, to promote public accountability, and to protect the interests of the taxpayers whose dollars fund the School.

Sincerely,

Robert A. Cerasoli

Robert A. Cerasoli
Inspector General

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Executive Summary

The Massachusetts charter school law, M.G.L. c. 71, §89, authorizes the Massachusetts Board of Education to grant charters to Commonwealth charter schools and Horace Mann charter schools, both of which are public schools managed by boards of trustees. This report concerns the Somerville Charter School (hereinafter, "the School"), which is a Commonwealth charter school. A Commonwealth charter school is a public school that operates independently of any school committee under a charter granted by the Board of Education. Since it was chartered in 1996, the School has contracted with SABIS Educational Systems, Inc. (hereinafter, "SABIS Inc."), a private, for-profit company, for comprehensive educational and management services.

The School, located in Somerville, was among 24 Commonwealth charter schools included in a study undertaken by the Office of the Inspector General in March 1998 pursuant to Chapter 46 of the Acts of 1997. In November 1999, the Office issued a report, *A Management Review of Commonwealth Charter Schools*, identifying weaknesses in the contracting practices, procurement procedures, and financial management of some schools. Such weaknesses could undermine the schools' ability to achieve their educational objectives and jeopardize the interests of state taxpayers whose dollars fund charter schools. The report findings regarding the School included the following:

- The School's management contract with SABIS Inc. contained no performance requirements measuring students' academic achievement, contained a compensation provision that posed unwarranted risks to the School and the taxpayers, did not accurately reflect the School's actual compensation arrangement with SABIS Inc., and contained provisions that could restrict public use of educational curricula and other intellectual property developed with public funds.

- The School's substantial financial obligations to SABIS Inc. could render the School excessively dependent on SABIS Inc., reduce the School's contracting leverage, and create liabilities for the Commonwealth's taxpayers.

- The School exhibited warning signs of financial problems that, if uncorrected, could threaten the School's future viability.

- The School reportedly failed to take timely actions to correct internal control deficiencies identified by their independent auditors.

- The School's written procurement procedures did not require advertised competition for purchases of supplies, services, or equipment.

The Office initiated the review presented in this report in November 1999. This review was conducted in accordance with generally accepted government auditing standards. The purpose of this review was to conduct a more detailed examination of certain aspects of the School's operations previously identified by the Office as potential sources of risk. During the course of this review, the Office obtained documents from the School and from SABIS Inc. covering the period of May 1996 through November 1999. The Office appreciates the cooperation provided to the Office by the School, SABIS Inc., and the DOE.

Under the charter school law, charter school trustees are "public agents" with ultimate responsibility for the school. The law provides:

> The board of trustees of a commonwealth charter school, upon receiving a charter from the board of education, shall be deemed to be public agents authorized by the commonwealth to supervise and control the charter school.

In 1995, the Executive Office of Education (EOE) issued a legal memorandum to charter schools providing a comprehensive overview of the statutes and regulations affecting the governance structure of charter schools. This legal memorandum emphasized that a Board of Trustees is responsible and accountable for ensuring that the charter school operates in accordance with the charter school law and regulations and in accordance with the representations made in the charter school application.

Charter school trustees are also required to fulfill certain fiduciary obligations or duties that apply to members of all boards of directors, whether their organizations are private or public. These duties are generally referred to as the "duty of care" (sometimes called the duty to be informed) and the "duty of loyalty." Because the Board of Trustees has statutory and fiduciary responsibility for oversight and control of the School, the findings and recommendations provided in this report are directed to the Board.

The detailed meeting minutes maintained by the Board of Trustees depict a committed and concerned board that has, since the School's inception, participated actively in decisions affecting the educational functions and programs of the School. However, the Office's review disclosed that the Board has not provided adequate oversight of the School's business operations. As the following findings show, the Board's contractual arrangement with SABIS Inc. has not enabled the Board to control, safeguard, or even obtain full information regarding the School's finances.

1. **The Board of Trustees has given SABIS Inc. excessive control over the school's operating funds.**
   - **The Board has allowed SABIS Inc. to deposit School funds in an operating account under SABIS Inc.'s exclusive control.**
   - **The Board has given SABIS Inc. excessive control over the School budget.**
2. **The School's management organization has impeded Board oversight of the SABIS Inc. contract and full Board access to essential School documents and information.**
3. **The Board of Trustees has inappropriately ceded responsibility to SABIS Inc. for selecting and engaging the services of the School's auditor.**
4. **The surplus provision contained in the School's 1996 contract with SABIS Inc. is disadvantageous to the School.**
5. **The Board's Finance Committee Chair and the Director of the School appear to hold conflicting views of loan agreements between the School and SABIS Inc.**
6. **Although the Board maintained detailed minutes of its regular meetings, it did not maintain records of its executive sessions.**

The Board of Trustees of the Somerville Charter School has been entrusted with the responsibility of operating a public school serving more than 700 children. The Commonwealth has invested more than $16 million in the School since 1996. Like other charter school boards of trustees, the School's Board of Trustees is comprised of unpaid members of the community who volunteer to devote time and effort to the worthy goal of improving educational opportunities for children. The meeting minutes kept by the Board show that the Board members have devoted substantial time and effort in service to the School since the School was founded in 1996.

It should also be recognized that charter schools in Massachusetts and elsewhere have been evaluated primarily on the basis of the academic progress of their students and have been given wide latitude in establishing their internal operating procedures. While the Department of Education's small charter school office has provided assistance to charter schools, it has not provided detailed information to charter school boards of trustees concerning their statutory and fiduciary obligations. Moreover, charter applicants and charter schools applying for renewal of their charters have not been required to demonstrate that they are capable of instituting and maintaining efficient, effective business systems and practices.

Nevertheless, strong, effective Board governance is essential to the School's long-term capacity to achieve its educational mission and to protect the interests of its students, their parents, and the taxpayers whose dollars fund the School. Accordingly, the Inspector General offers the following recommendations to address the issues raised in this report:

1. **The Board of Trustees should hire its own staff to oversee the School's business operations, including the contract with SABIS Inc.**

2. **The Board of Trustees should consider managing the School's business operations with its own staff when the School's 1996 contract with SABIS Inc. expires in 2001.**

3. **If the Board of Trustees elects to continue to contract for management of the School's business operations, the Board should:**

   - **Obtain the benefits of market-driven competition by using the best value contracting methods of M.G.L. c. 30B to obtain competitive proposals from qualified management contractors,**

   - **Discontinue the practice of allowing the management contractor to retain all surplus School revenues, and**

   - **Ensure that the new contract enables the Board to exercise appropriate oversight and control over School resources and operations.**

4. **The Board of Trustees should oversee the preparation and execution of the School's annual budget.**

5. **The Board of Trustees should select, contract with, and oversee the School's independent auditor.**

6. **The Board of Trustees should seek guidance regarding its fiduciary duty and establish procedures to comply with the requirements of the open meeting law.**

Introduction

The Massachusetts charter school law, M.G.L. c. 71, §89, authorizes the Massachusetts Board of Education to grant charters to Commonwealth charter schools and Horace Mann charter schools, both of which are public schools managed by boards of trustees. This report concerns the Somerville Charter School (hereinafter, "the School"), which is a Commonwealth charter school. A Commonwealth charter school is a public school that operates independently of any school committee under a charter granted by the Board of Education. Since it was chartered in 1996, the School has contracted with SABIS Educational Systems, Inc. (hereinafter, "SABIS Inc."), a private, for-profit company, for comprehensive educational and management services.

The School, located in Somerville, was among 24 Commonwealth charter schools included in a study undertaken by the Office of the Inspector General in March 1998 pursuant to Chapter 46 of the Acts of 1997. In November 1999, the Office issued a report, *A Management Review of Commonwealth Charter Schools*, identifying weaknesses in the contracting practices, procurement procedures, and financial management of some schools. Such weaknesses could undermine the schools' ability to achieve their educational objectives and jeopardize the interests of state taxpayers whose dollars fund charter schools. The report findings regarding the School included the following:

- The School's management contract with SABIS Inc. contained no performance requirements measuring students' academic achievement, contained a compensation provision that posed unwarranted risks to the School and the taxpayers, did not accurately reflect the School's actual compensation arrangement with SABIS Inc., and contained provisions that could restrict public use of educational curricula and other intellectual property developed with public funds.

- The School's substantial financial obligations to SABIS Inc. could render the School excessively dependent on SABIS Inc., reduce the School's contracting leverage, and create liabilities for the Commonwealth's taxpayers.

- The School exhibited warning signs of financial problems that, if uncorrected, could threaten the School's future viability.

- The School reportedly failed to take timely actions to correct internal control deficiencies identified by their independent auditors.
- The School's written procurement procedures did not require advertised competition for purchases of supplies, services, or equipment.

Objectives, Scope, and Methodology

The Office initiated the review presented in this report in November 1999. This review was conducted in accordance with generally accepted government auditing standards. The purpose of this review was to conduct a more detailed examination of certain aspects of the School's operations previously identified by the Office as potential sources of risk. During the course of this review, the Office obtained documents from the School and from SABIS Inc. covering the period of May 1996 through November 1999. The Office subsequently obtained documents pertaining to the School from the Massachusetts Department of Education (hereinafter, "DOE") covering the period from February 1996, the date of the School's charter application, through April 2000.

The Office also conducted interviews with the Chair of the Finance Committee of the Somerville Charter School Board of Trustees and with the former Regional Director for SABIS Inc. The Board's Finance Committee Chair, who was designated by the Board of Trustees to respond to the Office's questions, was a founder of the School. According to meeting minutes recorded by the Board of Trustees, he served as Chair or Co-Chair of the Board of Trustees from the School's inception in 1996 until early 1998 and from late 1998 until late 1999, when he was elected Treasurer of the Board of Trustees. SABIS Inc.'s former Regional Director, who served as Regional Director between 1998 and 2000 for the Somerville Charter School as well as two other Massachusetts schools contracting with SABIS Inc., was designated by SABIS Inc. to respond to the Office's questions. The Office appreciates the cooperation provided to the Office by the School, SABIS Inc., and the DOE. In December 2000, the Office provided the Board of Trustees with a confidential draft of this report. The Board's response to the confidential draft report is included in Appendix A of this report.

Charter School Boards of Trustees

Under the charter school law, charter school trustees are "public agents" with ultimate responsibility for the school. The law provides:

> The board of trustees of a commonwealth charter school, upon receiving a charter from the board of education, shall be deemed to be public agents authorized by the commonwealth to supervise and control the charter school.[1]

In 1996, the Executive Office of Education (EOE)[2] issued a legal memorandum to charter schools providing a comprehensive overview of the statutes and regulations affecting the governance structure of charter schools. This legal memorandum emphasized that a Board of Trustees is responsible and accountable for ensuring that the charter school operates in accordance with the charter school law and regulations and in accordance with the representations made in the charter school application.

Charter school trustees are also required to fulfill certain fiduciary obligations or duties that apply to members of all boards of directors, whether their organizations are private or public. These duties are generally referred to as the "duty of care" (sometimes called the duty to be informed) and the "duty of loyalty." A 1996 legal memorandum issued to charter schools by the former EOE provided the following explanation of the obligations of charter school trustees to fulfill the duty of care and the duty of loyalty:

> The Board of Trustees, as a public agent, is entrusted by the Commonwealth to supervise and control the charter school. Accordingly, the Board of Trustees is primarily responsible for ensuring the charter school's compliance with the charter school legislation.
>
> The Board of Trustees has two primary duties as a public agent: (1) the duty of care, and (2) the duty of loyalty. The duty of care means that each trustee must act with such care as an ordinary prudent person would employ in the trustee's position. This duty imposes on the trustee the responsibility of participating actively in the oversight of the charter

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[1] M.G.L. c. 71, §89(a).

[2] The EOE was responsible for charter school oversight until 1996, when the EOE was abolished. Since 1996, the Department of Education has been responsible for charter school oversight under the supervision of the Board of Education.

> school's activities. Such participation includes attending meetings, reviewing the school's code of conduct, financial reports, and other required documents, and monitoring delegated activities. The duty of loyalty means that the trustee must act in good faith and in a manner the trustee reasonably believes is in the best interest of the charter school.

Because the Board of Trustees has statutory and fiduciary responsibility for oversight and control of the School, the findings and recommendations provided in this report are directed to the Board.

Background on the Somerville Charter School

The Board of Education of the Commonwealth awarded a five-year charter to the School on March 14, 1996. The School began operations in September 1996 with approximately 450 students in kindergarten through eighth grade. Over the next three years, the School expanded to 681 students in kindergarten through eleventh grade. According to information published by the DOE, the School's projected enrollment for the 2000-2001 school year is 760 in kindergarten through twelfth grade. According to the School's published annual reports, the membership of the Board of Trustees has fluctuated between 13 and 15 since 1997.

According to the School's audited financial statements,[3] the School received more than $11 million in M.G.L. c. 70 funds[4] from the state between 1996, when the School was first chartered, and the end of the 1999 fiscal year. The School's audited financial statements also reported that the School received more than $900,000 in other revenues, such as federal and state grants, fees, and interest income during the same period. Table 1 lists the School's annual revenues.

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[3] The charter school law, M.G.L. c. 71, §89(hh), requires each charter school to obtain an annual, independent audit of its accounts and file the audit each year with the DOE and the State Auditor.

[4] M.G.L. c. 70 establishes standards for state funding of public schools in Massachusetts.

Table 1.
Somerville Charter School Revenues, FY 1997 - FY 1999

Fiscal Year	State Revenues (M.G.L. c. 70)	Other Revenues	Total
1997	$ 3,037,243	$294,284	$ 3,331,527
1998	3,813,015	239,727	4,052,742
1999	4,368,631	404,632	4,773,263
Total	**$11,218,889**	**$938,643**	**$12,157,532**

Source: Audited financial statements.

The School's audited financial statements for the 2000 fiscal year were unavailable for this review. However, according to information published by the DOE, the School received M.G.L. c. 70 funds totaling $5,368,298 in the 2000 fiscal year and is projected to receive M.G.L. funds totaling $5,638,142 in the 2001 fiscal year.

Background on SABIS Educational Systems, Inc.

In October 1996, the School executed a five-year contract with a private Minnesota-based company, SABIS Educational Systems, Inc., for comprehensive educational and management services. The effective date of the contract was July 1, 1996. The School's February 1996 charter application to the Board of Education provided detailed information on the SABIS Inc. curriculum and teaching methods as well as the following summary:

> SABIS Educational Systems, Inc. is the management and development arm of The SABIS School Network. The Network consists of 13 schools in 7 countries and had its start in 1886 in Beirut, Lebanon. The successful teaching method and curriculum are known throughout the Middle East as one of the finest college preparatory programs.

The School profile published by the DOE contained the following summary of the SABIS Inc. approach:

> As in the other worldwide network of schools operated by Sabis Educational Systems, Inc., students in this school wear uniforms and teachers use the "point" and "prefect" system of instruction to teach. For each lesson, teachers post the key points to be discussed in each class.

> Once the teacher covers a point, the work of student prefects is checked. Student prefects, usually numbering five per class, are chosen because they excel in a particular subject. Once the prefects have checked with the teacher to ensure they have mastered the "point," the prefects check the understanding of an assigned group of their classmates. Student leadership is further enhanced by the "Student Life" program in which students earn points for participation in various school activities that reflect the quality and extent of their contribution to the school's learning environment.

A table included in the School's charter application listed 14 schools in the SABIS Network, along with their opening dates, student populations, and percentage of SABIS Inc. ownership. Of the 14 schools listed, two were 100 percent owned by SABIS Inc. SABIS Inc.'s ownership interest in the other schools listed in the chart ranged from 0 percent to 25 percent. The charter application also provided detailed information on the SABIS Inc. curriculum and teaching methods. According to the SABIS School Network website, all schools in the SABIS Network had implemented the "SABIS Educational System." However, each school was financially and administratively independent.

Overview of the School's Business Relationship with SABIS Inc.

Under the School's 1996 contract with SABIS Inc., SABIS Inc. was responsible for administering all aspects of the School's business operations. The contract stated:

> RIGHTS AND OBLIGATIONS OF SABIS. Consistent with the obligations of the School under the Charter, the Act, and any and all applicable laws and regulations, and in order to assist the School in carrying out the terms of the Charter and the Act, SABIS shall have the following rights and obligations in connection with the operation of the School and education of the children enrolled as students in the School:
>
> AUTHORITY TO MANAGE SCHOOL
>
> 2.1.1 Subject to the provisions of this Agreement, and in accordance with the provisions of the Act, the Charter, and all applicable laws and regulations, SABIS shall be responsible for the operation of the School, including the responsibilities of the School set forth in paragraph 1.1, above, (except those provided in Section 1.1.5, which are reserved to the School), and SABIS shall have the right and obligation to educate the children enrolled in the School. That education shall include:

2.1.1.1 The education program and program of instruction, including student admissions, bilingual education (G.L. c. 71A), student records, access to equal educational opportunities, school year and school day requirements, special education (G.L. c. 71B, subject to the proviso of Section 1.1.1), student testing, extra and co-curricular activities and programs, and selection and acquisition of instructional materials, equipment and supplies.

2.1.1.2 Development and administration of the School's curriculum including course selection, content and sequencing . . .

2.1.1.3 Provide all personnel and payroll functions on behalf of the School for the teachers, staff and administrators who are employed by the School.

2.1.1.4 Professional development for principals and instructional personnel.

2.1.1.5 Maintenance and operation of the School's facilities provided pursuant to Section 1.5.

2.1.1.6 Administration of the School, its staff, facilities and programs.

2.1.1.7 Food services for the students and School staff.

2.1.1.8 Transportation services for the students.

The contract also stated:

SABIS shall assume and be solely responsible for all tasks and functions associated with the educational services to be provided to the children enrolled as students at the School in accordance with the Charter, the Act, and any and all applicable laws and regulations. Such tasks and functions shall include, but not be limited to, contracting with public or private entities or with private persons for:

2.2.1 Transportation;

2.2.2 Custodial services, supplies and equipment;

2.2.3 Food services;

2.2.4 Improvements to the building site as SABIS deems necessary for the implementation of its program . . . and

2.2.5 Any other services deemed reasonably necessary to achieve the goals of SABIS[.]

The management contract provided that SABIS Inc. would be entitled to a license fee – the amount of which was unspecified – for the use of SABIS Inc.'s proprietary information. The contract also provided that SABIS Inc. would receive any surplus amounts remaining after all School expenses had been paid each year.

In addition to contracting with SABIS Inc. for school management services, the School has leased property from SABIS Inc. since 1998. According to the School's audited financial statements, SABIS Inc.'s lease charges to the School totaled $166,667 for the 1999 fiscal year. The School's audited financial statements also reported substantial loans from SABIS Inc. to the School during the same period. According to the School's audited financial statements for the 1999 fiscal year, the School owed SABIS Inc. $978,937 as of June 30, 1999.

Findings

The detailed meeting minutes maintained by the Board of Trustees[5] (hereinafter, "the Board") depict a committed and concerned board that has, since the School's inception, participated actively in decisions affecting the educational functions and programs of the School. Many meeting minutes included lists of "action items" resulting from the Board meetings. The meeting minutes also showed that the Board planned workshops on Board governance, sought models for Board operations, and devoted substantial effort to defining the respective roles and responsibilities of the Board, the staff of the School, and SABIS Inc. In short, the meeting minutes indicate that the volunteers serving on the Board invested substantial time and care in service to the School.

However, the Office's review disclosed that the Board has not provided adequate oversight of the School's business operations. As the following findings show, the Board's contractual arrangement with SABIS Inc. has not enabled the Board to control, safeguard, or even obtain full information regarding the School's finances.

Finding 1. The Board has given SABIS Inc. excessive control over the School's operating funds.

The Office's review found that the Board has delegated excessive financial and administrative control to SABIS Inc., thereby undermining the Board's capacity to oversee the School's business operations and to monitor SABIS Inc.'s performance.

1a. The Board has allowed SABIS Inc. to deposit School funds in an operating account under SABIS Inc.'s exclusive control.

The Board's 1996 contract with SABIS Inc. provided:

> The School shall forward all funds received by it for tuition payments from any source to SABIS and SABIS agrees to use such tuition payments solely for the purposes and obligations contained in this Agreement. The

[5] The Board meeting minutes reviewed by the Office covered the period of May 18, 1996 through November 18, 1999.

parties shall agree upon the annual and projected Budgets prior to the commencement of each school year.

According to the Board's Finance Committee Chair, the Board transferred quarterly state tuition payments and other School funds received by the Board by issuing checks from the Board's bank account to a bank account controlled by SABIS Inc. and used to operate the School. He stated that these transfers were authorized by formal Board votes and that each check to the School's operating account was signed by two or three members of the Board. The Board meeting minutes confirmed that the Board routinely transferred quarterly tuition revenues received by the Board from the DOE, as well as School grant funds and other non-tuition revenues, to this account. Non-tuition revenues transferred to this account included federal and state start-up grants as well as grants for facilities, health education, advanced placement, smoking cessation, and professional development.[6] According to the Board's Finance Committee Chair, the Board exercised no further control over the School funds after they were transferred to the School's operating account.

Information provided by the School's attorney confirmed that the School's operating account was controlled exclusively by SABIS Inc. According to the School's attorney, two individuals had signatory authorization to withdraw funds from this account as of November 2000: SABIS Inc.'s Regional Director and the Lower School Coordinator, a School employee. No officer of the Board or School employee reporting to the Board had access to the School's operating account. (As will be discussed in Finding 2, all School employees have reported to SABIS Inc. since the School's inception in 1996.) Without access to or control over the School's operating account, the Board has lacked the capacity to control and safeguard School funds in accordance with its statutory and fiduciary responsibilities.

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[6] The scope of the Office's review did not include a determination as to whether or not these funds were handled and expended in accordance with the provisions of each grant.

The Board's Finance Committee Chair told the Office that the School's operating account has been controlled by SABIS Inc. since the School began operations. He stated that the Board's intent in establishing this arrangement was to treat all School funds transferred to SABIS Inc. – not only the license fee and surplus payments authorized in the 1996 contract – as SABIS Inc.'s payment for operating the School.

Records and information provided to the Office contained further evidence that the School's operating account has been controlled exclusively by SABIS Inc. According to a summary sheet dated January 31, 1997 contained in the Board meeting minutes, SABIS Inc. deposited funds in the School's operating account from locations out of state and overseas on several occasions. Table 2 lists the deposits shown on the summary sheet.

Table 2.
Deposits to School Operating Account
November 23, 1996 – December 16, 1996

Date	Description	Amount
6/12/96	SABIS Deposit	$300,000
9/23/96	SABIS Springfield Transfer	30,000
9/29/96	SABIS Deposit (transfer from #41851872)	45,000
10/2/96	SABIS Springfield Wire Transfer	250,000
11/1/96	SABIS Minnesota Wire Transfer	150,000
12/10/96	SABIS Minnesota Wire Transfer	100,000
12/16/96	SABIS Bath, UK Wire Transfer	99,983
	Total	**$974,983**

Source: Summary sheet dated January 31, 1997 and included in Board meeting minutes.

Furthermore, information provided by SABIS Inc.'s former Regional Director indicated that funds were transferred out of the School's operating account to another charter school, which also contracted with SABIS Inc. for educational and management services, on several occasions. The Office showed the former Regional Director the January 31, 1997 summary sheet as well as a spreadsheet of financial transactions

between the SABIS International Charter School and SABIS Inc. for the 1996, 1997, 1998, and 1999 fiscal years. This spreadsheet included a $76,776.92 entry labeled "Summer 1997 – Somerville Trfr." The former Regional Director provided the following written explanation to the Office:

> When the Somerville Charter School was opening, the Sabis International Charter School ordered materials and supplies from vendors (that school had no credit standing yet) in the amount of $30,000. Somerville Charter School repaid that amount. Nine days later the Somerville Charter School transferred $250,000 to the Sabis International Charter School. That amount was intended for [SABIS Inc.] in Minnesota. The $250,000 was sent transferred [*sic*] to the Somerville Charter school by the Sabis International Charter School.

The former Regional Director's letter thus confirmed that public funds were transferred on several occasions between the operating accounts of two independent Massachusetts public schools whose only connection was that they shared the same management contractor.[7] The fund transfers indicate that SABIS Inc. controlled the funds in the School's operating account and had discretion to withdraw funds for purposes unrelated to the Somerville Charter School without having to obtain approval from any Board member.

Under this scenario, the School's assets are extremely vulnerable to fraud, waste, and abuse. The Board's delegation of excessive financial control to SABIS Inc. has precluded meaningful Board control and oversight of the public funds that have been appropriated and designated for School operations.

This arrangement has also deprived the Board of an essential source of leverage in administering and enforcing the School's contract with SABIS Inc. Contract payments constitute the principal source of leverage available to any contracting organization. However, the Board has allowed SABIS Inc. to control all expenditures from the School's operating account – including fees and other payments to SABIS Inc. Under

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[7] The former Regional Director's letter did not address the $76,776.92 entry labeled "Summer 1997 – Somerville Trfr." on the SABIS International Charter School's spreadsheet.

this arrangement, the Board lacks the ability to withhold fees and other contract payments to SABIS Inc. even in the event of SABIS Inc.'s nonperformance.

1b. The Board has given SABIS Inc. excessive control over the School budget.

Under the charter school law, the Board is required to develop the School's annual budget. M.G.L. c. 71, §89(x) states:

> The board of trustees, in consultation with the teachers, shall determine the school's curriculum and develop the school's annual budget.

The budget is an essential public policy tool that serves as a guide for School expenditures and ensures that School funds are spent in accordance with the Board's decisions and priorities. The Board thus has an obligation to approve a budget, in advance of each fiscal year, that reflects its decisions and priorities.

Under the School's 1996 contract with SABIS Inc., the School and SABIS Inc. were required to agree on the School's annual and projected budgets prior to the commencement of each school year. This contract provision was inconsistent with the above-cited provision of the charter school law and undermined the Board's capacity to supervise and control the School. Moreover, the Board meeting minutes suggest that SABIS Inc. developed the budget with little direction or input from the Board. For example, according to the Board meeting minutes from July 9, 1998, SABIS Inc.'s Corporate Accounts Manager provided a financial report to the Board that included the following information on the School budget:

> The budget has been prepared and is waiting internal approval. It will provide more details than in the past. This was a previous request of the board.

In the context of the financial report, "internal approval" appears to refer to approval by SABIS Inc. The Board meeting minutes for October 8, 1998 – after the start of the school year – included a draft letter to SABIS Inc. from the Board Treasurer requesting

documentation and clarification of 10 financial issues, including "a formally documented and detailed budget for the Fiscal Year 1999."[8]

The Board meeting minutes also showed that because of delays that were apparently caused by SABIS Inc., the Board had not even seen the preliminary 1999-2000 budget developed by SABIS Inc. before this budget information was published in the School's 1998-1999 annual report. The Board meeting minutes contained a July 23, 1999 letter from the Co-Chair of the Board to the Acting Associate DOE Commissioner that stated, in part:

> As the deadline for submission of The Somerville Charter School's annual report approaches, I wanted to let you know that our Board of Trustees has not had an opportunity to review and approve the preliminary budget that will appear in the report. A draft was not available from SABIS (our management company) at our July 22nd meeting. Thus, the budget will appear in the report with the notation that it is subject to Board approval. We expect SABIS to present the budget at our September meeting.

The minutes for Board meetings held in September, October, and November 1999 contained no indication that SABIS Inc. presented the preliminary budget to the Board or that the Board took any action on that budget. Moreover, the Board meeting minutes contained no record of Board votes on any School budgets during the first four years of School operations.

The Board's Finance Committee Chair acknowledged that the School's budget was prepared by SABIS Inc. However, he stated that the Board reviewed and approved the budgets and that the Board meeting minutes did not reflect the Board's extensive discussions regarding the amounts that should be spent on various School programs and activities. He stated that when the Board felt that spending should be increased in specific areas, the Board discussed and negotiated these spending issues with SABIS Inc. and that SABIS Inc. has never refused to provide funding in response to the Board's requests.

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[8] The Board's inadequate access to information regarding the School's business operations is discussed in Finding 2 of this report.

The fact that the Board has had to submit such requests to SABIS Inc. reflects the weakness of the Board's financial control and leverage. The Board has a fiduciary duty to manage and safeguard the public funds provided to the School. Accordingly, the authority to decide how School funds are spent must rest with the Board – not with SABIS Inc. By allowing SABIS Inc. excessive budgetary control, the Board has undermined its own capacity to protect the financial interests of the School.

Finding 2. The School's management organization has impeded Board oversight of the SABIS Inc. contract and full Board access to essential School documents and information.

The charter application submitted to the Board of Education in February 1996 by the School's founders indicated that the Board planned to put SABIS Inc. in charge of all School employees. The application provided the following description of the internal form of management to be implemented at the School:

> The Somerville Charter School will be managed by SABIS. The Head of School [Director] is responsible for the day-to-day operation of the charter school and maintaining school records. The Head of School receives ongoing direction from SABIS, which in turn is accountable to the Board of Trustees within the framework of a management contract and an annually approved budget.

According to the Board's Finance Committee Chair, the Board's original intent was that SABIS Inc. would pay the School's staff with the tuition funds transferred to SABIS Inc. by the Board. However, he stated that when the School began operations, the Board was told by the DOE that the paychecks of School staff had to be issued from a bank account controlled by the Board, and not from a bank account controlled by SABIS Inc., in order to enable the staff to participate in the Massachusetts Teachers' Retirement System. According to the Board's Finance Committee Chair, the Board instructed SABIS Inc. to deposit funds for staff salaries into a special payroll account controlled by the Board, and SABIS Inc. has continued to handle staff salaries in this manner. He stated that the Board regarded these payroll funds as SABIS Inc.'s funds, despite the fact that the payroll account was controlled by the Board.

In November 1998, the Board adopted a set of Policy Statements that further clarified the Board's relationships to SABIS Inc. and to the School's staff. Under "Role of the Board," the Policy Statements listed six functions, including "[m]onitor and assess the performance of the management company." Under "Board-Staff Relationship Policies," the Policy Statements confirmed the organizational arrangement established in 1996:

> Teachers and staff are employees of the School but are accountable to the Director and the Management Company, and will not have a direct relationship to the Board. The Management Company is directly accountable to the Board. The formal reporting and supervision process between the Management Company and the Board is outlined more specifically in the Charter School Contract.
>
> All Board authority delegated by contract to the Management Company shall be administered through the Director and monitored and assessed by the Board, so that all authority and accountability of staff, as far as the Board is concerned, is considered to be the authority and accountability of the Director.

Thus, although all School staff were and continue to be public employees paid from a Board-controlled account, they have reported to and been supervised by SABIS Inc. since the School began operations. Under this organizational arrangement, the Board cannot effectively monitor and oversee SABIS Inc.'s performance under the 1996 contract. Although the Board meeting minutes indicate that Board members have devoted substantial time and effort to the School, these members – like members of other charter school boards of trustees – are community volunteers whose availability may be limited. Moreover, since all of the School's employees have been required to report to SABIS Inc., no School employee could reasonably have been expected to monitor SABIS Inc.'s performance.

The Board meeting minutes show that the Board encountered difficulty in attempting to monitor SABIS Inc.'s performance in administering the School's business operations. The School's auditor wrote to the Board identifying a series of deficient internal controls

at the School in December 1997, December 1998, and August 1999.[9] In each of the three annual letters, the auditor criticized the School's lack of an accounting policies and procedures manual. The Board meeting minutes show that the Board closely reviewed the auditor's December 1997 letter. The Board meeting minutes for March, June, October, and December 1998 indicated that the Board questioned SABIS Inc. regarding SABIS Inc.'s plans for addressing the internal control deficiencies identified by the auditor, including the lack of an accounting policies and procedures manual. However, as the following chronology shows, SABIS Inc. did not take steps to develop an accounting policies and procedures manual for the School until May 2000:

- December 22, 1997: The School's auditor identified problems with the School's internal control structure, including the School's lack of an accounting policies and procedures manual.

- March 12, 1998: The Board meeting minutes reported that SABIS Inc.'s corporate accounting manager had advised the Board that "accounting policy and procedures have been made clear."

- December 16, 1998: The School's auditor identified problems with the School's internal control structure, including the lack of an accounting policies and procedures manual.

- August 17, 1999: The School's outside auditor identified problems with the School's internal control structure, including the lack of an accounting policies and procedures manual.

- November 1999: A report issued by the Office of the Inspector General included a finding that the School had failed to take timely action in response to repeated recommendations from its outside auditors to remedy deficient internal controls, including the lack of an accounting policies and procedures manual.

- May 30, 2000: The School Director sent a letter to the Inspector General, stating: "An accounting manual is in the process of being developed. . . . "

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[9] The Office's 1999 report on Commonwealth charter schools discussed the School's reported failure to take timely action to correct a reportable condition and other internal control deficiencies noted by the School's auditor in 1997. A reportable condition is a significant internal control deficiency that could adversely affect the School's ability to record, process, summarize, and report financial data consistent with the assertions in the School's financial statements.

This example illustrates the pitfalls of having the Board directly oversee SABIS Inc. If a staff person hired by and accountable to the Board had been responsible for oversight of SABIS Inc.'s performance in implementing the audit recommendations, it is likely that SABIS Inc. would have developed the accounting policies and procedures manual more promptly.

In addition to precluding effective Board oversight of the School's contract with SABIS Inc., the School's management organization appears to have hampered the efforts of various members of the Board, including the Treasurer, to obtain information regarding the School's financial transactions with SABIS Inc. The Board meeting minutes showed that the Board repeatedly requested basic information from SABIS Inc. regarding the School's financial arrangements with SABIS Inc. For example, the School's audited financial statements reported interest charged to the School by SABIS Inc. totaling more than $150,000 in the 1997 and 1998 fiscal years. The minutes of a Board meeting held on July 9, 1998 indicated that the Board's Treasurer lacked information regarding the basis for the interest charges and was unable to obtain this information from the SABIS Inc. representative attending the meeting. The minutes stated:

> Was interest charged on the management fees? [The Board Treasurer] saw nothing in the contract indicating there should be interest charges. [The SABIS Inc. representative] was not able to answer the question based on the information he had at hand at the meeting.

The Treasurer's question was appropriate: the 1996 contract with SABIS Inc. did not specify either a management fee or an interest rate on late payment of fees. (In fact, as will be discussed in Finding 4, the contract stated that SABIS Inc. would "bear sole financial responsibility" for any School deficits.) Board minutes from subsequent Board meetings contained no indication that the Treasurer's question was answered.

The Board minutes also included a draft letter to SABIS Inc. from the Board Treasurer dated October 8, 1998, requesting documentation and clarification of 10 financial issues, including the following:

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> All contracts and agreements pertaining to "revolving line of credit," and supporting documentation in determining how monies are transferred into this account.
>
> All contracts and agreements pertaining to Management/AMS fees, and supporting documentation in determining what percentage the fees are calculated on (Chapter 70 or total revenue); Supporting contracts and agreements pertaining to interest charges on the above fees.
>
> Final Financial Statements for the Fiscal Year ending June 30, 1998 and Auditors notes and reports.
>
> A formally documented and detailed budget for the Fiscal Year 1999.

The Board clearly needed to review and understand these important School records in order to fulfill its fiduciary responsibilities. Having granted excessive control to SABIS Inc., however, the Board apparently had no access to these public records – including the Board's own contracts with SABIS Inc. – other than by requesting these documents from SABIS Inc. itself.

Moreover, the Policy Statements adopted by the Board in November 1998 authorized SABIS Inc., through the School's Director, to "deny or delay" Board requests for information if such requests could be shown to "impede any higher priority business of the School." The full provision was as follows:

> The Director may deny or delay requests for resources, assistance, or information from Board-delegated individuals, committees, or task forces if the Director can show that such requests will impede any higher priority business of the School.

The implication that the Director has the authority to accord lower priority to Board requests to SABIS Inc. is troubling. The Board is the public body charged by law with the responsibility for governing the School. The Board – and only the Board – should establish the School's priorities, and neither SABIS Inc. nor any other private contractor should be permitted to "deny or delay" Board requests for information.

Finding 3. The Board of Trustees has inappropriately ceded responsibility to SABIS Inc. for selecting and engaging the services of the School's auditor.

The charter school law requires each charter school to obtain an annual, independent audit of its accounts and file the audit each year with the DOE and the State Auditor.[10] The independent audit is the DOE's principal source of information regarding each school's financial condition. The DOE's charter school regulations require a charter school applicant to demonstrate its ability to achieve fiscal and operational viability within the five-year charter term in order to obtain charter approval.[11] The Board of Education may revoke a charter for financial insolvency.[12] Similarly, DOE regulations require a charter school seeking renewal of its charter to demonstrate its financial viability,[13] and the DOE's charter renewal application indicates that the DOE relies on the audited financial statements and other information furnished by the school's independent auditor to make this determination.

The annual audit of the School is thus an important responsibility of the Board of Trustees, and the audited financial statements that the Board submits each year to the DOE and the State Auditor are essential accountability tools. However, the Board has inappropriately delegated responsibility for the annual audits to SABIS Inc. The Board meeting minutes show that an audit firm located in Minneapolis, Minnesota – near SABIS Inc.'s corporate headquarters in Eden Prairie, Minnesota – was retained to perform the School's audits for the 1997 and 1998 fiscal years. The Board meeting minutes contained a memorandum dated May 29, 1997 to the Board from the School's Administrative Director, advising the Board that an audit firm located in Minneapolis, Minnesota had been retained. The memorandum stated:

> Three firms were solicited to provide bids. Of the three, one returned a "no bid" response. [The Minnesota audit firm] returned the lower of the

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[10] M.G.L. c. 71, §89(hh).

[11] 603 CMR 1.05.

[12] 603 CMR 1.12.

[13] 603 CMR 1.11.

two actual bids. Their bid price included a fixed cost for expenses, including travel.

In an interview with the Office, SABIS Inc.'s former Regional Director stated that SABIS Inc. had selected this audit firm to conduct audits of all schools operated by SABIS Inc. in the United States.[14]

The School's audited financial statements for the 1999 fiscal year were prepared by a certified public accounting firm located in Springfield, Massachusetts. The Board's meeting minutes contained no discussion of how or why this firm was selected.[15]

The Accountability Plan submitted by the School to the DOE in August 1999 stated that SABIS Inc. was responsible for preparing audited financial statements as well as the operating budget. The Accountability Plan stated:

> SABIS has established an operating budget, manages the payroll of the school's employees, reports annual audited financial statements, reports and pays any taxes due, and purchases insurance policies for the physical plant, school employees and the Board of Trustees. The school conforms to the requirements of the Massachusetts Teacher Retirement Board.

The tasks of selecting and contracting with a charter school's independent auditor should reside with the charter school's Board of Trustees rather than being carried out by its management contractor because a properly conducted independent audit should provide the Board with information on the management contractor's performance. In this case, however, the Board of Trustees of the Somerville Charter School allowed SABIS Inc. to select and engage the services of its own auditor to conduct the School's

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[14] A report issued by the Office in November 2000 regarding the SABIS International Charter School, which contracted with SABIS Inc. for comprehensive school management services, disclosed that this same Minnesota audit firm prepared the SABIS International Charter School's audited financial statements for the 1998 fiscal year. The report also found that the Board of Trustees of the SABIS International Charter School had inappropriately ceded responsibility to SABIS Inc. for selecting and engaging the services of the School's auditor.

[15] The Office's November 2000 report on the SABIS International Charter School disclosed that this same Springfield audit firm prepared the SABIS International Charter School's audited financial statements for the 1996, 1997, and 1999 fiscal years.

audits. This arrangement raises serious concerns about the independence of the School's audits.

Finding 4. The surplus provision contained in the School's 1996 contract with SABIS Inc. is disadvantageous to the School.

The School's 1996 contract with SABIS Inc. provided that SABIS Inc. would be entitled to receive a license fee, the amount of which was unspecified in the contract, and to retain any surplus remaining after all School expenses had been paid each year. The contract also stated that if no surplus remained, SABIS Inc. would "bear sole responsibility" for all remaining expenses. Specifically, the contract stated:

> Any surplus remaining from tuition payments after all expenses of the School and the Trustees have been paid shall be retained by SABIS as profit. In the event that no surplus of funds remains from the tuition payments after expenses of the School and the Trustees have been paid, SABIS shall bear sole financial responsibility for all remaining expenses and neither the School nor the Trustees shall have any obligation to contribute additional funds.

The School's audited financial statements reported that SABIS Inc. charged the School a management fee and "corporate support" expenses in addition to the surplus payments and license fees authorized in the contract.[16] Table 3 summarizes the fees, corporate support expenses, and surplus payments charged to the School by SABIS Inc. over the three fiscal years ending on June 30, 1999.

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[16] The Office's November 1999 report on Commonwealth charter schools contained a detailed discussion of the fees charged by SABIS Inc. and the lack of provisions in the School's 1996 contract with SABIS Inc. regarding the management fee or the corporate support charges reported in the School's audited financial statements.

Table 3.
SABIS Inc. Charges to the School

Charges	FY97	FY98	FY99	Total
Surplus	$136,082	$343,896	$392,265	$ 872,243
Management	189,191	228,781	262,121	680,093
License	189,191	228,781	262,121	680,093
Corporate support	168,638	41,815	43,790	254,243
Total	**$683,102**	**$843,273**	**$960,297**	**$2,486,672**

Source: Audited financial statements.

As the table shows, the School's surplus revenues totaled $872,243 over the three-year period and amounted to more than one-third of SABIS Inc.'s charges under the 1996 contract.

The above-cited provision of the School's 1996 contract with SABIS Inc. requiring the School to pay its surplus revenues to SABIS Inc. each year is disadvantageous to the School in several respects. As discussed in the Office's 1999 report on Commonwealth charter schools, a compensation provision that bases a management contractor's payment on the charter school's surplus revenues at the end of each fiscal year creates a disincentive for the management contractor to make or recommend certain expenditures that may be warranted, since any expenditure reduces the school's potential surplus and, thus, the contractor's compensation. In the Office's view, there is no public policy justification for an arrangement that creates these incentives. Any contractual arrangement that creates incentives for a private contractor to act in ways that do not serve the contracting organization's interests is a high-risk proposition for the organization.[17]

[17] The importance of incentives in principal-agent contracts has been well documented. See, for example, Robert D. Austin, *Measuring and Managing Performance in Organizations*, Dorset House Publishing, 1996, and Edward E. Zajac, *Political Economy of Fairness*, The MIT Press, 1995.

In addition, this type of compensation provision eliminates the opportunity for a school to reinvest surplus funds in school operations and to share in the financial benefits of any efficiency measures or cost-saving strategies implemented during the fiscal year. If the school is required to pay its surplus revenues to the management contractor each year, the school cannot retain a fund balance to cover contingencies or meet future program investment needs. For these reasons, the interests of the Somerville Charter School would be better served by a contract provision that specifies the dollar amount of the fee to be paid to SABIS Inc. for the contracted services.

Finding 5. The Board's Finance Committee Chair and the Director of the School appear to hold conflicting views of loan agreements between the School and SABIS Inc.

The School's audited financial statements reported that the School borrowed substantial sums from SABIS Inc. between the 1996 fiscal year and the 1999 fiscal year,[18] that the loan principal was payable on demand, that the interest rate charged by SABIS Inc. was 10 percent, and that the School incurred interest charges on this debt totaling $153,299 in the 1997 and 1998 fiscal years.[19] The Office's November 1999 report raised concerns about the School's mounting debt to SABIS Inc., as reported in the School's audited financial statements, as well as the lack of a written loan agreement specifying the annual interest rate, repayment schedule, and purpose of each loan from SABIS Inc. to the School.[20]

In response to the Office's report, the Director of the School wrote a letter to the Inspector General in May 2000 summarizing the School's actions and action plan in response to the November 1999 report. With respect to the report's findings regarding

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[18] The School's audited financial statements reported that the School owed SABIS Inc. $1,150,098 as of June 30, 1997; $1,139,2332 as of June 30, 1998; and $978,937 as of June 30, 1999.

[19] The School's audited financial statements reported interest charges only in the 1997 and 1998 fiscal years.

[20] In 1997 and 1998, the School's auditor criticized the lack of written loan agreements documenting the terms and conditions of the loan agreements between the School and SABIS Inc.

the School's loans from SABIS Inc., the Director's letter stated that formal loan agreements with applicable interest rates and terms would be executed:

> Finding 7 [of the Office's November 1999 report] noted that loan agreements between charter schools and management companies could render the schools excessively dependent on their management contractors while reducing the schools' contract leverage. We agree that formal loan agreements with applicable interest rates and terms between the management company and Somerville Charter School are necessary and will use them.

The Director's letter did not indicate whether the views expressed in the letter reflected those of SABIS Inc., the Board, or both. As discussed in Finding 2, the Director has been paid by the School but has reported to SABIS Inc. under the management organization established by the Board.

In an interview with the Office conducted in September 2000, the Board's Finance Committee Chair contradicted the information provided in the Director's letter. He advised the Office that the Board has never approved any loans to the School from SABIS Inc.; that, contrary to the information reported in the School's audited financial statements, the School has no outstanding debts to SABIS Inc.; and that the Board has no intention of executing any formal loan agreements with SABIS Inc. in the future.

As previously discussed in this report, the Board has allowed SABIS Inc. to select and engage the services of the School's auditor each year. The fact that the Board's Finance Committee Chair regards the School's audited financial statements as inaccurate is cause for concern. If the School's audited financial statements do not fully and accurately reflect the Board's financial decisions, then their value as an accountability tool is questionable. The apparent disagreement between the Board's Finance Committee Chair and the School's Director underscores the importance of ensuring that the Board assumes responsibility for the School's annual audits in the future.

Finding 6. Although the Board maintained detailed minutes of its regular meetings, it did not maintain records of its executive sessions.

Charter school boards of trustees like other governmental bodies, are subject to the requirements of the open meeting law. Under M.G.L. c. 30A, §11A½, boards of trustees are required to maintain minutes, setting forth the date, time, place, members present or absent, and actions taken, of each meeting, including executive sessions. Executive sessions are not public meetings. The open meeting law specifies the required procedures in order for the governmental body to go into executive session as well as the purposes for which executive sessions may be held.

The open meeting law requires meeting minutes to become public records and be available to the public, provided that executive session minutes may remain secret as long as publication may defeat the lawful purposes of the executive session, but no longer. All votes taken in executive sessions must be recorded roll call votes and must be recorded in the executive session minutes.

The Board meeting minutes reviewed by the Office indicate that the Board held at least six executive sessions between April 1997 and September 1999. Although the minutes of the regular Board meetings were detailed and informative, no minutes were recorded for the executive sessions held by the Board.

The Board is required to comply with all applicable laws and regulations, including the open meeting law, as a condition of its charter. In addition, the Board has an obligation to ensure that its executive sessions meet the same accountability standards as those maintained in the regular Board meeting minutes. Charter school advocates maintain that public disclosure – or "transparency" – is an essential component of charter school accountability.[21] Commonwealth charter schools, which are not subject to the jurisdiction of local school districts and are exempt from many regulations governing

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[21] See "Accountability Via Transparency" by Chester E. Finn, Bruno V. Manno, and Gregg Vanourek in a Heritage Foundation report entitled *School Choice 1999: What's Happening in the States.*

other public schools, have a special obligation to disclose information about their operations to interested parties in the community and elsewhere.

Conclusion and Recommendations

The charter school law authorized the establishment of public charter schools supervised and controlled by public boards of trustees. As the governing body, a charter school board of trustees is obligated to manage the public funds provided to the school in a manner that serves the school's educational mission and protects the interests of the school. Oversight of the school's finances and business operations is thus an essential component of a board's governance responsibilities.

The Board of Trustees of the Somerville Charter School has been entrusted with the responsibility of operating a public school serving more than 700 children. The Commonwealth has invested more than $16 million in the School since 1996. Like other charter school boards of trustees, the School's Board of Trustees is comprised of unpaid members of the community who volunteer to devote time and effort to the worthy goal of improving educational opportunities for children. The meeting minutes kept by the Board show that the Board members have devoted substantial time and effort in service to the School since the School was founded in 1996.

However, the findings summarized in this report show that the Board has not provided effective oversight of the School's finances and business operations. Instead, the Board has ceded excessive control over the School's finances and business operations to its private management contractor, SABIS Inc. In doing so, the Board has diminished its own capacity to control the public funds provided to the School and to oversee the management contractor's performance in administering those funds.

Charter schools in Massachusetts and elsewhere have been evaluated primarily on the basis of the academic progress of their students and have been given wide latitude in establishing their internal operating procedures. While the Department of Education's small charter school office has provided assistance to charter schools, it has not provided detailed information to charter school boards of trustees concerning their statutory and fiduciary obligations. Moreover, charter applicants and charter schools applying for renewal of their charters have not been required to demonstrate that they

are capable of instituting and maintaining efficient, effective business systems and practices.[22]

Nevertheless, strong, effective Board governance is essential to the School's long-term capacity to achieve its educational mission and to protect the interests of its students, their parents, and the taxpayers whose dollars fund the School. Accordingly, the Inspector General offers the following recommendations to address the issues raised in this report:

1. **The Board of Trustees should hire its own staff to oversee the School's business operations, including the contract with SABIS Inc.** The Board's staff should be responsible for recommending sound business systems and procedures to the Board; ensuring that the Board receives timely and accurate information; reviewing and approving all financial transactions between the School and SABIS Inc.; monitoring SABIS Inc.'s performance; and advising the Board on major policy decisions affecting the School's finances and business operations.

2. **The Board of Trustees should consider managing the School's business operations with its own staff when the School's 1996 contract with SABIS Inc. expires in 2001.** For example, the Board could reconfigure the School's management organization so that the School staff responsible for the School's business operations are directly accountable to the Board. The Board could then execute discrete contracts for School support services that the Board believes would best be provided through contracts. Any such service contracts should be awarded using the best value contracting methods of M.G.L. c. 30B to obtain competitive bids or proposals from qualified service providers.

3. **If the Board of Trustees elects to continue to contract for management of the School's business operations, the Board should:**

   a. **Obtain the benefits of market-driven competition by using the best value contracting methods of M.G.L. c. 30B to obtain competitive proposals from qualified management contractors.**

   b. **Discontinue the practice of allowing the management contractor to retain all surplus School revenues.** The Board should instead ensure that the contract specifies the dollar amount of the fee or other basis of compensation to provide fair payment to the management contractor for the services specified in the contract.

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[22] The Office's 1999 report on Commonwealth charter schools contained detailed recommendations for strengthening the DOE's oversight of Massachusetts charter schools.

c. **Ensure that the new contract enables the Board to exercise appropriate oversight and control over School resources and operations.** The contract should contain clear provisions regarding the contract performance requirements, compensation terms and schedule, and reporting requirements.

4. **The Board of Trustees should oversee the preparation and execution of the School's annual budget.** The Board should prepare and approve the budget in advance of the fiscal year, as required by the charter school law, to ensure that the budget reflects the Board's priorities and the School's obligations, is consistent with past experience, and contains reasonable projections of revenues and expenditures. During the fiscal year, the Board should monitor the School's revenues and expenditures against the projections in the approved budget.

5. **The Board of Trustees should select, contract with, and oversee the School's independent auditor.** Contractors should have no role in procuring or managing the School's annual audits.

6. **The Board of Trustees should seek guidance regarding its fiduciary duty and establish procedures to comply with the requirements of the open meeting law.**

Appendix A: Response of the Somerville Charter School Board of Trustees

SOMERVILLE
CHARTER SCHOOL

January 12, 2001

By Hand

RECEIVED
JAN 12 2001
OFFICE OF
INSPECTOR GENERAL

Robert A. Cerasoli
Inspector General
Office of the Inspector General
One Ashburton Place – Room 1311
Boston, MA 02108

Re: Somerville Charter School - Report of the Office of the Inspector General

Dear Mr. Cerasoli:

This letter responds to your Office's draft report on The Somerville Charter School. On behalf of the Board of Trustees, I wish to thank you for affording us the opportunity to review and comment on the report. We appreciate the professional manner in which this review was conducted and the time that your staff spent reviewing records and meeting with Board representatives. We also appreciate your statements recognizing the substantial time and care Board members have invested in service to the school. We plan to continue our work in providing quality educational services to students and believe that your report provides us with information that will assist us in our efforts.

We do have several concerns with the findings and recommendations of the draft report. The practices and procedures questioned in the report are consistent with, and often required by, the terms of our charter and our contract with SABIS, the School's educational management company. As you know, the provisions of both the Charter and contract were approved by the Executive Office of Education and have remained endorsed by the Department of Education (DOE) under the Charter School Statute as an appropriate option for developing innovative educational programs in Massachusetts. It would, thus, appear that many of the concerns raised in the draft report would best be addressed to the legislature or the DOE. We will, of course, follow changes to the statute and to the regulations and administrative advisories that may be forthcoming from the DOE.

Also of concern is what we view as the report's mischaracterization of the records that are subject to the annual independent audit required by M.G.L. c.71,

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§89(hh) and of the Board of Trustee's financial obligations to SABIS.[1] Further, the draft report omits the fact that the Board has succeeded in leveraging public funds for the infusion of over five million dollars of non-recourse private investment capital from Sabis. The report thus fails to accurately reflect the financial benefit that the Board has gained for our students, our school, and the taxpayers. Despite these concerns, however, we believe that the questions you have raised are important ones and that we can use the report as a resource in strengthening our financial and management structure.

In response to the recommendations concerning executive session minutes, we now realize that we had misunderstood the requirements of the Open Meeting Law as it applies to executive sessions in which no vote was taken. We are working with legal counsel on this point.

In conclusion, the Board wishes to state that it takes its fiduciary responsibilities very seriously. Our contractual arrangement with Sabis, though not perfect, provides Sabis with the financial incentive to continue to make capital investments in facilities and equipment for our school and has enabled us to succeed in improving educational performance for our students. The Board believes, above all, that the educational success of our students will serve the public interest for many years to come.

Moreover, while we believe that a number of the issues raised in the draft report, if of concern, would most appropriately be addressed through either amendments to the charter school law or regulations, we also recognize that the report provides the Board with information that we can and will use in refining and improving the management and financial structure of our school.

Very truly yours,

Harold H. Oshima
The Somerville Charter School
Board of Trustees

IG-01-1-6

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[1] The relevant contractual language states, in part, "…Sabis shall bear sole financial responsibility for all remaining expenses, and neither the School nor the Trustees shall have any obligation to contribute additional funds."